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SUBJECT: CHILE'S COMPETING ECOMOMIC VISIONS: A POSSIBLE PREVIEW OF THE PRESIDENTIAL CAMPAIGN

¶1. (SBU) SUMMARY: The Chile 21 Foundation (a think tank affiliated with Chile's Socialist party) organized a seminar late last month to discuss the current global economic situation and its impact on Chile. Minister of Finance Andres Velasco reviewed the GOC's economic policy designed to combat the effects of the crisis. Socialist Senator Carlos Ominami, President of Chile 21, called for "new fundamentals" in the national economy, as well as a new international financial architecture. Noted economist Felipe Larrain provided an opposing view, emphasizing the need to increase the national economy's competitiveness and productivity. Disagreement broke out between representatives of labor and private business over who will "pay" for the costs of the economic downturn in Chile. The conference offered a possible preview of the candidates' competing economic views in the upcoming presidential election. END SUMMARY.

Economic Backdrop: Sailing in Choppy Seas

¶2. (SBU) Chile 21's conference comes amid a series of gloomy predictions and expectations for the economy in 2009. Analysts, economists, politicians, academics, and "the man on the street" all agree that the year will be difficult for all sectors of the economy. In November 2008, the Central Bank forecast that Chile's GDP will grow at 2-3% in 2009, a view shared by many experts. However, the more pessimistic view predicts growth of 1-1.9%. Consumption is expected to experience a dramatic slowdown from 9.2% to about 0.6%. Most economists also expect that private investment, for the first time in years, will contract significantly due to restrictions in credit and less appetite for risk.

¶3. (SBU) Many experts believe unemployment will break the 10% threshold, in part driven by the decrease in demand for Chilean exports and the contraction in investment. The real economy is already feeling the effects with double-digit drops in exports, housing and real estate sales, car sales, and purchases at supermarkets and retail chains. Inflation is easing, but new risks may emerge such as price deflation, which could result from depressed global demand and the end of the commodity boom.

The GOC's Fiscal Policy: We Are Keynesians

¶4. (SBU) Minister Velasco was the key note speaker. He emphasized that Chile is an open economy and cannot avoid the effects of the crisis. However, the country enjoys advantages that can soften the brunt of the crisis. He noted Chile has managed to maintain a healthy fiscal position with low public-sector debt (only 4.1% of

GDP), a significant surplus (13.3% of GDP), and a low country-risk premium (between 220 to 400 basis points).

¶5. (SBU) Velasco explained that the sound fundamentals of the economy will allow Chile to react to external shocks with counter-cyclical policy. The GOC can stimulate domestic demand, offset the contraction of external demand, and implement more expansive fiscal policy through its recently unveiled US $4 billion stimulus plan. In 2009, Government spending will increase and, due to a temporary reduction in the structural surplus rule (from 0.5% of GDP to 0%), it will likely run a deficit. However, Velasco stressed the majority of the GOC measures will be temporary. He said the goal is to "beat the crisis." [Note: Although, some with a more cynical mindset see the goal as mitigating the effects of the crisis in a year of presidential elections. The issue of economic stability could prove to be a decisive factor for voters. End note.]

In This Corner: Empower the State

¶6. (SBU) Socialist Senator Carlos Ominami, President of Chile 21, began his presentation by saying: "The fall of Wall Street is to deregulated capitalism what the fall of the Berlin Wall was to communism." Ominami faulted the lack of appropriate international regulation and supervision for the crisis. Chile's regulations have helped assure its financial system is not at risk. The response to a global crisis should include a new international financial architecture and a rethinking of the risk classification system.

¶7. (SBU) Ominami cited several major risks for Chile: a deterioration in the quality of public policies, a tendency to promote short-term answers to long-term problems, and a drop in the degree of social cohesion (including unemployment, a decrease in pensions, an increase in poverty, and widening income inequality). The State was key in promoting solutions. However, the GOC needed reforms to increase transparency, efficiency, and professionalism. The Ministry of Finance needed to strengthen counter-cyclical policies, reinforce employment, and create a universal, non-discriminatory unemployment system. Ominami said Chile 21 is working on a proposal for the platform of probable Concertacion presidential candidate Eduardo Frei.

And In This Corner: Empower Business

¶8. (SBU) Felipe Larrain, well-known economist and influential advisor of Alianza presidential candidate Sebastian Pinera, offered an opposing view. He argued that temporary measures such as tax breaks, investment incentives, and lower costs for liquidity, should be made permanent. Chile had suffered a significant drop in its productivity and competitiveness. Larrain noted that the loss of Chile's economic dynamism dated back to the Asian Crisis, when Eduardo Frei was President. Average growth over the last decade had been 3.8%, but was greater than 7.0% before the Asian Crisis.

¶9. (SBU) Larrain believed Chile would experience at least four years of consistently lower growth, with increases in investment and jobs, but with lower and lower returns. He faulted rigidities in the labor market, lack of qualified labor, and excessive dependence on exports of commodities, as much as the crisis. Almost 70% of Chile's exports were natural resources, and copper and molybdenum alone accounted for 59% of the total. The GOC would need to help the private sector by creating a more flexible labor market, facilitating access to credit for small- to medium-sized enterprises, and relaxing monetary policy.

Workers vs. Employers: Who Will Pay?

¶10. (SBU) A disagreement broke out between the president of the Association of Public Employees (ANEF), Raul de la Puente, and the president of the Confederation of Production and Commerce (CPC), Rafael Guilisasti. Quoting President Obama, de la Puente held that the crisis was caused by a lack of market supervision, which caused over 20 million layoffs around the world. The GOC had not been able to guarantee stable employment or workers' rights in Chile. He called on businessmen to lower their profit margins and prevent layoffs. Guilisasti countered by warning against a loss of trust

and confidence. He thought an antagonistic stance by the workers would only worsen the social climate. Unemployment insurance, training that would permit the rapid re-conversion of the labor force, and direct employment subsidies, were the best way to face unavoidable unemployment in 2009.

Comment: A Possible Preview of the Campaign

¶11. (SBU) Chile 21's seminar gives us a first glimpse of the economic issues that could dominate the debate during the presidential campaign this year. Pinera and Frei (the likely opposing candidates) probably will not change most current economic policy or Chile's overall model. However, the public's rising discontent with the political class will be exacerbated by the economic downturn. Solutions to the crisis will occupy a significant portion of the presidential campaigns and the GOC's political agenda in 2009.
SIMONS